[JOINT COMMITTEE PRINT]

DESCRIPTION OF THE ADMINISTRATION'S PAYMENT-IN-KIND (PIK) PROGRAM, INCLUDING TAX ISSUES RAISED BY THE PROGRAM

SCHEDULED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON
SELECT REVENUE MEASURES

OF THE

COMMITTEE ON WAYS AND MEANS

ON

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PREPARED BY THE STAFF

OF THE

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INTRODUCTION

The Subcommittee on Select Revenue Measures of the Committee on Ways and Means has scheduled a public hearing on November 3, 1983, on the Administration's payment-in-kind (PIK) program. The hearing will examine the effects of the 1983 PIK program and whether the special tax provisions enacted for participants in that program should be extended for participants in such programs for the 1984 crop year.

The first part of this document is a summary of the PIK programs and the special tax provisions enacted for the 1983 program. The second part is a description of the 1984 PIK program, announced by the Administration on August 9, 1983. The third part is a description of the 1983 PIK program. The fourth part provides data on participation in the 1983 program, and the fifth part is a description of the special tax provisions enacted for the 1983 PIK program.

I. SUMMARY

For the 1983 crop year, the Department of Agriculture adopted a payment-in-kind (PIK) program under which farmers were paid with commodities for diverting all or certain portions of their farmland from production. The 1983 crop year program applied to wheat, corn, sorghum, rice, and upland cotton.

The Agriculture Department has announced a continuation of this program for the 1984 crop year for wheat only. The Department also has announced that the program will not be continued for corn, grain sorghum, and upland cotton for the 1984 crop year. It is uncertain at this time whether the 1984 program will be continued for or expanded to other crops.

The Payment-in-Kind Tax Treatment Act of 1983 (the "1983 Act") [1] provided that income from commodities received in a 1983 PIK program is recognized on the date on which the commodities are sold rather than on the date the commodities are received (or constructively received). These special tax provisions generally applied only to crops grown in the 1983 crop year. When the PIK program was announced, USDA determined that the $50,000 limit on payments under acreage reduction programs did not apply to in-kind payments. On November 1, 1983, the General Accounting Office issued a determination that the limit does apply (see Appendix I).

Additionally, the 1983 Act generally treated income from PIK commodities as active income derived from the business of farming for all purposes under the Internal Revenue Code. For example, income from PIK commodities is treated as earned income to persons who materially participate in the conservation use to which the PIK real property is devoted for purposes of the self-employment income (SECA) tax, income tax credits, and the social security benefit provisions.

The 1983 Act also provided that real property withdrawn from production in exchange for a payment-in-kind under a 1983 PIK program is treated as used in an active farming (e.g., qualified) use by the person entering the PIK contract for purposes of the estate tax current use valuation and installment payment provisions. An individual who materially participates in the conservation use to which real property withdrawn from production under the 1983 PIK program is devoted is treated as materially participating in a farming operation in which the PIK property is used.

Under the 1983 Act, the treatment of PIK commodities as participant-produced crops also applies to commodities received by cooperatives under a PIK program. The Treasury Department was directed to prescribe rules treating commodities received under a

[1] Public Law 98-4, March 11, 1983

PIK program by a cooperative as patronage source income from the sale of commodities produced by the cooperative's patrons.

The 1983 Act includes a special anti-speculation rule that limits the tax provisions to land acquired by any person before February 24, 1983, unless the acquisition occurs by reason of death, by reason of gift, or is from a member of the transferee's family. Under this rule, acquisition of an 80-percent or more interest in a crop from any land is treated as acquisition of the land.

Finally, the 1983 Act provided that a study of the effects of the PIK program and the tax treatment under the 1983 Act be required from the Secretary of the Treasury no later than September 1, 1983. As of the present date, that study has not been submitted to the Congress.

II. DESCRIPTION OF THE 1984 PAYMENT-IN-KIND PROGRAM

Overview

The Department of Agriculture's ("USDA") 1984 payment-in-kind program, announced August 9, 1983, is a program for diverting from production land which otherwise would be used to produce wheat. Under the program, producers are provided a quantity of wheat as compensation for diverting acreage normally planted in that crop.

The 1984 PIK program is in addition to the other established acreage limitation and paid land diversion programs available to farmers. The other programs provide for cash, rather than in-kind, payments. Farmers must be participants in these programs as a condition of eligibility for the PIK program.

In the case of the cash payment programs, present law limits payments to any farmer to a maximum of $50,000. When the PIK program was announced, USDA determined that the $50,000 limit on payments under acreage reduction programs did not apply to in-kind payments. On November 1, 1983, the General Accounting Office issued a determination that the limit does apply (see Appendix I).

The 1984 PIK program is similar in many respects to the 1983 PIK program (described in Part III). There are, however, three main differences between the 1984 and the 1983 programs: the 1984 program is limited to in-kind payments of wheat; in 1984 no payments will be made from Commodity Credit Corporation stocks—payments will be made only from commodities held under reserve loans, regular loans and "harvest-for-PIK" loans; and farmers will not be able to divert their whole crop acreage base in 1984, as was possible under the 1983 program.

PIK Program

General rules

Under the 1984 PIK program, farm producers generally may elect to divert from 10 to 20 percent of their wheat acreage base [1] from active crop production in exchange for a payment-in-kind equal to an established quantity of the wheat normally grown on the property. The established quantity is 75 percent of the farm's program yield [2] multiplied by the acres diverted under the PIK program.

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[1] The term "wheat acreage base" means the average of the acreage planted and considered planted to wheat in 1982 and 1983.

[2] The term "farm program yield" means the yield of wheat from the farm property during an established historical reference period.

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Property withdrawn from crop production under a 1984 PIK program is required to be devoted to conservation uses. Land designated for conservation use must have been devoted to row crops or small grains in two of the last three years except for a summer fallow farm. Under the summer fallow rules the land must be acreage that would have been planted to small grains or row crops in 1984 absent the 1984 wheat program. PIK acreage may be grazed other than during the six principal growing months of the PIK crop. Harvesting of any crop from land diverted under a 1984 PIK program generally is prohibited.

Executed PIK contracts are transferable by the farmer under certain circumstances; however, transfer of a PIK contract could terminate the farmer's qualification for any special tax provisions that may be enacted, if the provisions enacted for the 1984 PIK program are similar to those that applied to the 1983 PIK program (discussed in Part III). Therefore, if special tax provisions are similar to those enacted for the 1983 program were enacted for the 1984 program, upon assignment of a PIK contract, the farmer would recognize income, which income would not be treated as income derived from the active conduct of farming.

Payment procedures

Participating farmers are eligible for payment-in-kind on a date established for their locality. The payment availability dates will reflect the usual harvest dates of wheat in different regions. Farmers may receive payment on the established availability date, or they may elect to defer receipt of the payment for any period of time up to 5 months thereafter. The Federal Government bears all risk of loss and storage costs until payment is received by the farmer.

In-kind payments of wheat are to be paid only from wheat acquired by the Federal Government through transactions the substance of which is forfeiture of collateral for regular and Farmer-owned Reserve [3] ("FOR") price support loans made under price support programs administered by the Commodity Credit Corporation ("CCC").[4] The regular CCC and FOR programs are similar, except CCC loans are normally made for a 9-month period while FOR stocks generally are held off the market for up to 5 years. In the case of payment from farm-stored FOR stocks, unlike the 1983 participants, farmers in the 1984 PIK program will not be eligible for additional storage costs beyond the normal 5 months allowed under the PIK program.

Producers with no outstanding loans must agree to harvest for PIK in order to receive a PIK payment, i.e., to grow their own PIK commodities on other land they farm. Price support loans will be

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[3] A portion of the commodities will be acquired through transactions, the substance of which is loan cancellation, with farmers who have such loans outstanding immediately before they receive payments of commodities under the PIK program.

[4] The CCC is a Federally-owned corporation which administers the farm price support program through grants of loans on crops eligible for support. The CCC establishes an annual loan rate per unit for each crop eligible for Government price supports. CCC then makes nonrecourse loans to farmers for their crops based upon this rate. If the market price for the crop rises above the loan rate, the farmer can redeem the crop, sell it, and retain any excess proceeds over the loan rate plus accrued interest and other charges. If the market price does not rise above the loan rate before the loan's due date, the farmer can forfeit the crop to the Government in full satisfaction of the loan.

made to farmers growing their own PIK. These loans will be secured by the commodities to be produced. Those producers with no outstanding loans who are unable to harvest for PIK will not receive a PIK payment.

The method of payment under the PIK program takes the form of a three-step transaction. First, the farmer repays outstanding loans (reserve loans, regular loans, or harvest-for-PIK loans) equal to the PIK payment.[5] At that time, this collateral is released. Second, the Government repurchases the released commodities for an amount equal to the amount of the repaid loan (plus any accrued interest and charges paid by the farmer on repayment of the loan). Finally, the Government returns the commodities to the farmer as a payment-in-kind under the PIK contract.

Farmers may elect to have cooperatives receive payments otherwise due them provided the farmers have no outstanding CCC loans themselves. The payment procedures for cooperatives are generally the same as for individual farmers dealing directly with the Government. The cooperative's wheat loans must be used to satisfy the PIK requirements in the following order: reserve loans, regular loans and, finally, harvest-for-PIK loans. To meet the harvest-for-PIK requirement, the cooperative must obtain loans on eligible 1984 crop wheat to satisfy the designated PIK quantity in excess of outstanding reserve or regular loans. The cooperative will not be permitted to repay 1984 crop wheat loans unless a sufficient quantity of wheat remains under loan to satisfy PIK needs. PIK payments to cooperatives are to be held in pools separate from other crops held by the cooperatives.

Cash Payment Acreage Reduction Program

As under the 1983 PIK program, farmers are required to participate in the acreage limitation and paid diversion programs as a prerequisite of eligibility for the 1984 PIK program. These programs predate the PIK programs and consists of two facets. First, the farmer must divert from production an established percentage of his or her acreage base in exchange for diversion payments. The payment is a prescribed amount per crop unit times the farm program payment yield for each acre diverted. Second, the farmer must divert from production an additional percentage of his or her otherwise planted crop acreage for no pay. As with the so-called paid diversion, this no-pay percentage varies with the crop involved.

Under the 1984 wheat program, producers must limit 1984 wheat planted acreage to no more than 70 percent of the farm's wheat base (i.e., the acreage reduction requirement is 30 percent), and devote to conservation use an acreage of eligible cropland equal to 42.86 percent of the 1984 planted and PIK acreage.

Participation in the acreage reduction programs also entitles the farmer to price support loans and deficiency payments with respect to crops actually produced. The deficiency payments are equal to the excess of an established "target" price over the greater of the

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[5] Producers with reserve loans will be required to use those loans before a regular loan can be used. If a producer has more than one reserve loan, the producer may choose which reserve loan to repay.

year's CCC loan value for the crop or the crop's national average market price. The 1984 target price for wheat is $4.45 per bushel and the national average loan rate is $3.30 per bushel.

III. DESCRIPTION OF THE 1983 PAYMENT-IN-KIND PROGRAM

Overview

The Department of Agriculture's 1983 payment-in-kind program was a program for diverting from production land which otherwise would be used to produce crops of wheat, corn, sorghum, rice, and upland cotton. Under the program, producers were provided a quantity of a commodity as compensation for diverting acreage normally planted in that commodity.

As with the 1984 program, the 1983 PIK program was in addition to the other established acreage reduction programs available to farmers. The other programs provide for cash, rather than in-kind, payments. Farmers must be participants in these cash payment programs as a condition of eligibility for the PIK program.

In the case of the cash payment programs, present law limits payments to any farmer to a maximum of $50,000. When the PIK program was announced, USDA determined that the $50,000 limit on payments under acreage reduction programs did not apply to in-kind payments. On November 1, 1983, the General Accounting Office issued a determination that the limit does apply (see Appendix I).

PIK Program

General rules

Under the PIK program, farm producers generally could elect to divert from 10 to 30 percent of their crop acreage base [1] from active crop production in exchange for a payment-in-kind equal to an established quantity of the commodity normally grown on the property. The established percentage was the farm's program yield [2] times 95 percent for wheat and 80 percent for corn, grain, sorghum, upland cotton, and rice multiplied by the PIK acreage.

In lieu of the guaranteed 10 to 30 percent PIK diversion election, farmers could elect to divert the whole crop acreage base (other than property in the other diversion programs) for the farm on a bid basis. If a whole crop bid was made, the farmer offered to reduce his or her planted acreage of the crop to zero. As part of the bid, the farmer specified the percentage of the farm's program yield that he or she would accept as compensation. The lowest bids were accepted first. If the whole base bid was accepted, the bid compensation rate applied to the entire PIK acreage. If the whole

[1] The term "crop acreage base" means the acreage devoted to production of the crop involved during a base period. The crop base is presently established under the Omnibus Reconciliation Act of 1982.

[2] The term "farm program yield" means the yield of the crop covered by a PIK contract on the farm property during an established historical reference period.

base bid was not accepted, the farmer was still entitled to PIK diversion of 10 to 30 percent of his or her crop acreage base at the established compensation rate for the crop involved.

Whether whole base PIK bids were accepted depended on the amount of property for which PIK elections were made in the county where the property was located. The total acreage withdrawn from production of a crop under all Federal Government land diversion programs could not exceed 50 percent (later changed to 45 percent) of the total acreage base for the crop in any county. All 10 to 30 percent elections were accepted before any whole base bids were accepted.

If a farmer had a crop base in more than one crop included in the PIK program, he or she could elect to utilize the program for any combination or all of the crops. The total crop base diverted could not, however, exceed the total acreage comprising the farm.

Property withdrawn from crop production under a 1983 PIK program was required to be devoted to conservation uses. Generally, this should have resulted in the property being planted with a cover crop to prevent erosion and otherwise being permitted to lie fallow. PIK acreage could be grazed other than during the six principal growing months of the PIK crop. Harvesting of any crop from land diverted under a 1983 PIK program generally was prohibited.

Executed PIK contracts are transferable by the farmer under certain circumstances; however, transfer of a PIK contract terminates the farmer's qualification for the special tax provisions, discussed in Part V. Therefore, upon assignment of a PIK contract, the farmer recognized income, which income was not treated as income derived from the active conduct of farming.

Payment procedures

Participating farmers were eligible for payment-in-kind on a date established for their locality. The payment dates ranged from June 1 for wheat in certain Southern areas to November 1 for corn in certain Northern States. The payment availability dates reflected the usual harvest dates of PIK crops in different regions. Farmers could receive payment on the established availability date, or they could elect to defer receipt of the payment for any period of time up to five months thereafter. The Federal Government bears all risk of loss and storage costs until payment is received by the farmer.

As USDA originally designed the 1983 PIK program, PIK commodities were to be paid from surplus commodities held by the Federal Government and from commodities held as collateral for outstanding loans. The Federal Government acquires these commodities through transactions the substance of which is forfeiture of collateral for regular and Farmer-owned Reserve ("FOR") price support loans made under price support programs administered by the Commodity Credit Corporation ("CCC"). For a more detailed description of the CCC and FOR programs, see Part II.

Because of higher than anticipated participation, in certain cases, the Department of Agriculture had to purchase crops grown in 1983 and other crops not held under existing loan arrangements to make 1983 PIK payments.

The method of payment under the PIK program varies, depending on whether the farmer has outstanding loans with the CCC or has grain in the FOR. If the farmer has no commodities pledged under these programs, he or she receives payment from Government stocks of the commodity involved. If the farmer has commodities pledged under either of the programs, the payment takes the form of a three-step transaction. First, the farmer repays an amount of his or her outstanding loans equal to the PIK payment. [3] At that time, a pro rata portion of the loan security is released. Second, the Government repurchases the released commodities for an amount equal to the amount of the repaid loan (plus any accrued interest and storage charges paid by the farmer on repayment of the loan). Finally, the Government returns the commodities to the farmer as a payment-in-kind under the PIK contract.

Special procedures for upland cotton and rice

Under the 1983 program, PIK payments of upland cotton and rice generally are made by the Government to a farmer's cooperative. If an upland cotton or rice producer markets his or her crop through a cooperative, the cooperative receives the payment otherwise due the farmer under the PIK contract. Other farmers could elect to have cooperatives receive payments otherwise due them provided the farmers have no outstanding CCC loans themselves. The payment procedures for cooperatives are the same as for individual farmers dealing directly with the Government.

Cash Payment Acreage Reduction Program

As stated in the Overview, farmers were required to participate in the acreage limitation and paid diversion programs as a prerequisite of eligibility for the PIK program. These programs predate the PIK program and consists of two facets. First, the farmer must divert from production an established percentage of his or her acreage base in exchange for diversion payments. This required percentage varies with the crop—wheat, feed grains, corn, rice, and upland cotton. The payment is a statutorily prescribed amount per crop unit times the farm program payment yield for each acre diverted.

Second, the farmer must divert from production an additional percentage of his or her otherwise planted crop acreage for no pay. As with the so-called paid diversion, this no-pay percentage varies with the crop involved (e.g., 10 percent of planted acreage for corn during the 1983 crop year.)

These two diversion requirements generally result in approximately 20 percent of the farmer's crop acreage base being withdrawn from production in addition to any land so withdrawn under the PIK program. As with acreage in the PIK program, property withdrawn under the cash payment program must be devoted to conservation use.

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[3] Except in the case of upland cotton, the farmer could choose which loans to repay. Cotton loans were required to be repaid in the order in which the crops under loan were produced.

Participation in the acreage reduction programs also entitles the farmer to price support loans and deficiency payments with respect to crops actually produced. The deficiency payments are equal to the excess of an established "target" price over the greater of the year's CCC loan value for the crop or the crop's national average market price.

IV. OVERVIEW OF PARTICIPATION IN THE 1983 PAYMENT-IN-KIND PROGRAM

Participation

In January 1983, the Department of Agriculture estimated that 212 million acres of farmland would be planted in 1983 absent any acreage reduction or payment-in-kind program. To reduce planted acreage, and thereby anticipated crop surpluses, USDA adopted the 1983 PIK program.

Current estimates are that 80 million acres of farmland were in fact taken out of production in 1983 under the PIK and earlier acreage reduction programs. Of these 80 million acres, 11 million acres were taken out of production under acreage reduction programs by farmers who did not participate in a PIK program.

Farmers who participated in a PIK program were required to participate in the acreage limitation and paid diversion programs as a prerequisite of eligibility for a PIK program. Of the 69 million acres taken out of production by the farmers who participated in a PIK program, 48 million acres were taken out of production under the PIK program and 21 million acres under other acreage reduction programs.

The PIK program had been expected to result in a total acreage reduction of 21.6 million acres compared to 1983 planted acreage without PIK. Participation in the program was much greater than had been anticipated; the 48 million acres taken out of production under the PIK program is more than double the expected acreage reduction.

The enrollment in the 1983 PIK program, according to preliminary data, is shown in the following table. The enrollment ranged from 31.9 percent for wheat up to 74.2 percent for rice. Enrollment in the cotton program was also substantial at 62.3 percent.

PARTICIPATION IN THE 1983 PIK PROGRAM, BY CROP [1]

Crop	Farms enrolled in PIK[2] (number)	Total farms [2] (number)	Farms enrolled in PIK (Percent)
Wheat	298,522	936,785	31.9
Corn and grain sorghum	599,005	1,499,250	40.0
Cotton	85,665	137,536	62.3
Rice	16,271	21,937	74.2
Total	999,463	2,595,508	38.5

[1] Based on preliminary estimates of enrollment prepared by the General Accounting Office based on Department of Agricultural data.

[2] Farms that participated in the PIK program for more than one crop are included in the enrollment number for each crop. Thus, the total number of farms enrolled in the PIK program may be overstated to the extent farms are counted more than once.

Large Payments

Present law limits to $50,000 the total annual cash payments that can be made to any farmer under an acreage reduction program. When the PIK program was announced, USDA determined that the $50,000 limit on payments under acreage reduction programs did not apply to in-kind payments. On November 1, 1983, the General Accounting Office issued a determination that the limit does apply (see Appendix I).

Some commentators have pointed out that payments larger than those that would be permitted under cash acreage reduction programs have been made to some PIK participants.

In order to identify large PIK payments, the General Accounting Office reviewed payments to 708 farms in nine different States pursuant to a request by Subcommittee Chairman Stark. The farms were not selected statistically because sufficient data were not available for a statistically valid survey. The information from this limited review is useful, however, because it provides an indication of the number and size of some large PIK payments.

The average value of the commodities received on these 708 farms under the PIK program was $175,000. Thirty-five of the 708 farms received commodities valued in excess of $500,000. Of these 35 farms, seven farms received commodities valued in excess of $2,000,000.

In cases where a farm received payments for more than one crop, only the payment for the major crop was included in this data. Thus some of these farms may have received even larger amounts in total from all crops.

V. DESCRIPTION OF THE PAYMENT-IN-KIND TAX TREATMENT ACT OF 1983

Overview

The tax treatment of income from commodities produced by farmers is subject to numerous special rules under the Internal Revenue Code. Similarly, eligibility for a number of special income and estate tax provisions depends upon whether a taxpayer is (or a decedent was) either (1) engaged in the trade or business of farming, or (2) has income derived from the active conduct of the trade or business of farming.

Had the Payment-in-Kind Tax Treatment Act of 1983 (the "1983 Act") [1] not been enacted, participants in a 1983 PIK program could have been ineligible for many of the special income and estate tax provisions that are available to farmers since PIK commodities generally are not produced by the recipient in the active conduct of a farming operation. Even if such commodities are so produced, they have in effect been sold to the Government and returned to the PIK participant as consideration for withdrawal of farm land from production.

The 1983 Act modified the tax law to provide that participants in a 1983 PIK program generally are treated in a manner similar to that which would apply if they had actually grown the PIK commodities on the land withdrawn from production. Since the provisions of the 1983 Act apply only to land withdrawn from production during the 1983 crop year, payments received with respect to land withdrawn from production during the 1984 crop year generally will not be treated as income received from commodities produced by PIK participants in the active conduct of a farming operation.[2]

Income Tax Treatment of Farmers

Timing of income

Generally, taxpayers engaged in farming may determine their income for Federal income tax purposes under either the cash or accrual method of accounting. Under the cash method of account-

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[1] Public Law 98-4, March 11, 1983. H.R. 1296, a bill relating to the tax treatment of commodities received under the 1983 payment-in-kind program, was the subject of hearings on February 23, 1983 held by the Subcommittee on Select Revenue Measures of the Committee on Ways and Means. The bill, as amended, was reported by the Committee on Ways and Means on March 2, 1983 (H. Rept. 98-14). The House approved the bill on March 8, 1983 by a record vote of 401 to 1 under suspension of the rules. The Senate approved the bill on March 8, 1983 with amendments. On March 9, the House concurred in the Senate's amendment with amendment. On March 10, 1983, the Senate concurred in the House amendment, clearing the measure for the President.

[2] Winter wheat received as a PIK payment with regard to land withdrawn from production under a PIK program for the 1984 crop year remains eligible for the special treatment otherwise accorded only payments with respect to land withdrawn from production during the 1983 crop year. This rule applies only if the 1984 crop would have been planted before January 1, 1984, but for participation in a 1984 PIK program.

ing, income is recognized for the year in which it is actually or constructively received (Treas. reg. sec. 1.446-(c)(i)(ii)). Under the accrual method of accounting, income generally is recognized when all of the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy, regardless of when received. (Treas. reg., sec. 1.446-(c)(i)(ii)).

If a commodity is produced by a farmer, the farmer generally recognizes income only (1) when the commodity is sold or otherwise disposed of to a third party, or (2) when livestock, etc. to which a commodity is fed is sold or otherwise disposed of to a third party. Because the 1983 Act treats PIK commodities as farmer-produced, these rules apply to such commodities. Had the 1983 Act not been enacted, however, under both the cash and accrual methods of accounting, farmers would have recognized income when the commodities were made available to them regardless of when actually received. The amount to be included in income would have been the fair market value of the commodity on the date the taxpayer recognized the income.

Other income tax provisions

Under the 1983 Act, for all purposes of the Internal Revenue Code, income from the sale or exchange of PIK commodities is treated as income from the trade or business of farming and the taxpayer is treated as using in the trade or business of farming any land diverted from production under a 1983 PIK program. Thus, income with respect to the sale or exchange of such commodities is treated as gross income from farming for purposes such as the following:

(1) The special rules under which farmers may be excused from making quarterly payments of estimated tax if they file their returns and pay their tax in full by March 1 of the year following the year for which the quarterly estimates otherwise would have been required (secs. 6015(g), 6073(b), and 6153(b));

(2) The rules governing whether cash or accrual accounting methods must be used in determining income from farming (sec. 447);

(3) Provisions permitting expensing rather than capitalizing of certain expenditures for soil and water conservation (sec. 175), for fertilizer (sec. 180), and for clearing land (sec. 182);

(4) Restrictions on deducting certain expenses incurred in activities not engaged in for profit (sec. 183);

(5) Treatment of gain realized from disposition of property used in farming or farm losses offsetting farm income (sec. 1251);

(6) Limitations on the deduction of investment interest (sec. 163);

(7) The tax on the unrelated business income of charitable, etc., organizations (sec. 511); and

(8) The tax on personal holding companies (sec. 541).

Income tax treatment of cooperatives

A cooperative is an organization, usually operating in corporate form, which is established and operated for the mutual benefit of its members and patrons by selling goods to them or purchasing

products for them and returning to them any income in excess of costs (subchapter T and sec. 521).

Unlike other corporations, a cooperative is allowed a deduction from its taxable income to the extent patronage source income is distributed to its members or patrons as patronage dividends or in redemption of a non-qualified written notice of allocation. In addition, a cooperative may exclude from gross income amounts attributable to qualified per-unit retain allocations and redemptions of non-qualified per-unit retain certificates.

Exempt farmers' cooperatives are allowed more beneficial tax treatment than other cooperatives in that they are allowed a deduction for dividends paid from nonpatronage source income and a deduction for certain amounts paid as dividends on their capital stock.

The 1983 Act treated income from commodities received on behalf of PIK participants as patronage source income which is deductible and excludible to both exempt and nonexempt cooperatives provided there is a duty to allocate the income from the sale or disposition of the PIK commodities.

Employment tax treatment of farmers

Self-employed farmers, like other self-employed individuals, are subject to the social security (SECA) tax on their net earnings. Only income realized from a farming operation in which the farmer "materially participates" is considered earned income subject to the SECA tax.

The 1983 Act provides that income from the sale or exchange of any PIK commodity will be subject to the SECA tax for any individual who materially participates in the diversion and devotion to conservation use required for the property withdrawn from production under the PIK program.

Estate tax treatment of farmers

The estate tax current use valuation provision and installment payment provision are available only in cases where property used in an active trade or business is included in the decedent's gross estate. The current use valuation provision requires that the decedent or a member of the decedent's family have materially participated for specified periods in the farming operation in which specially valued real property was used.

The current use valuation provision permits executors of decedents whose estates are comprised largely of real property used in the trade or business of farming to elect to value the real property for estate tax purposes based upon its current use rather than its full fair market value (sec. 2032A). The installment payment provision permits similarly situated estates to pay estate tax attributable to a closely held business in installments over up to 14 years (sec. 6166). In addition, certain amounts of the tax paid in installments under section 6166 accrues interest at a special 4 percent rate rather than at the higher deficiency rate otherwise applicable when payment of a tax is delayed (sec. 6601(j)).

The 1983 Act treats land withdrawn from production under a 1983 PIK program as used in the active trade or business of farming for purposes of these two estate tax provisions. In addition, ma-

terial participation in the conservation use to which land withdrawn from production under a 1983 PIK program is put is treated as material participation for purposes of the current use valuation provision's requirement that such participation in the farming operation occur.

Taxpayers eligible for special tax treatment

Only qualified taxpayers are eligible for the special treatment accorded by the 1983 Act. A qualified taxpayer is a taxpayer who is a producer (as defined in Department of Agriculture regulations) of agricultural commodities within the meaning of a 1983 PIK program and who diverts farm acreage from production and devotes such acreage to a conservation use in return for receiving a commodity under the program. Thus, a taxpayer who receives income from assignment of a PIK contract or an assignee of such a contract is not a qualified taxpayer under the Act.

Anti-speculation rule

To prevent speculation in farm land as a result of a PIK program, the 1983 Act included a special anti-speculation rule that generally limits application of the special income and estate tax treatment accorded interests in property withdrawn from production to persons who owned the withdrawn property on February 23, 1983. Certain property interests acquired by reason of death, gift, or otherwise from a family member continue to qualify for the special treatment after the interests are transferred.

Treasury Study

The 1983 Act required the Secretary of the Treasury (after consultation with the Secretary of Agriculture) to conduct a study on the 1983 PIK program and the tax treatment accorded participants in the PIK program by the committee bill. The study was to include an analysis of the relative benefits accorded PIK participants by income class and by actual dollar amounts received for different crops and to address the relative income and tax benefits of the PIK program as compared to income and tax benefited that would have been received by owners of farm property had actual crop production occurred.

In addition, the study was to include an analysis of the cost-effectiveness of the PIK program as compared to other types of agricultural support programs, and also any effect that farmland diversion programs in general have on the cost-benefit analysis of other Federal Government programs, such as reclamation projects, which are frequently justified in part as increasing the amount of arable land available for farming.

APPENDIX I

U.S. GENERAL ACCOUNTING OFFICE,
Washington, D.C., November 1, 1983.

Hon. JOHN R. BLOCK,
The Secretary of Agriculture.

DEAR MR. SECRETARY: We have many reviews ongoing in response to congressional interest in various aspects of the Department of Agriculture's 1983 Payment-In-Kind (PIK) program. Most of the reviews have been requested by committee or subcommittee chairmen. In addition to responding to specific congressional requests, we also plan to issue an overall report to the Congress in the summer of 1984 on the management and effectiveness of the 1983 program.

In regard to our overall effort, my staff asked our General Counsel for legal clarifications on three specific issues relating to the PIK program, including the applicability of the $50,000 payment limitation to PIK payments. In developing our position, our General Counsel reviewed and discussed the Department's legal position on the payment limitation with Department attorneys.

As the enclosed memorandum from our General Counsel to me states, we have concluded that the $50,000 limitation does apply to PIK payments. We would appreciate being advised of any views you may have and/or any actions you intend with regard to our legal opinion.

Sincerely yours,

J. DEXTER PEACH, *Director.*

Enclosure.

[Memorandum from the U.S. Government General Accounting Office, October 31, 1983]

To: Director, RCED.
From: Acting General Counsel—Harry R. Van Cleve.
Subject: Questions Regarding the Legality of the Payment-in-Kind Program (B–211462–O.M.; Code 022866).

This responds to questions posed by your staff regarding the authority of the Department of Agriculture and the Commodity Credit Corporation (CCC) to conduct the Payment-in-Kind (PIK) program.

The PIK program is a land diversion program established by regulations published on January 12, 1983. The program, conducted by the Department of Agriculture through the CCC, makes payments in the form of commodities to producers of wheat, feed grains, upland cotton, and rice to divert acreage from the production of those crops for the 1983 crop year and to devote that acreage to approved conservation uses. Payments to participating producers are made from existing stocks of CCC commodities. Also, CCC has acquired additional stocks of commodities specifically to meet PIK entitlements.

Your questions concerning the PIK program and our answers, in brief, are as follows:

Question 1. Does the Department of Agriculture have statutory authority to conduct a land diversion program featuring payments-in-kind rather than cash payments?

Answer. Yes. The authority of the Secretary of Agriculture under the Agricultural Act of 1949, as amended, to make land diversion payments to producers of wheat, feed grains, upland cotton, and rice, in conjunction with CCC's statutory authority, is sufficient to support a payment-in-kind program. The relevant statutory provisions do not define the term "payment" or specify a method of payment. The concept of "payment" generally is understood to encompass payments-in-kind as well as in cash. Nothing in the language or legislative history of the statues suggests that a more restrictive interpretation was intended for land diversion payments.

Question 2. Does the statutory $50,000 limitation on the total amount of payments a person may receive under programs for wheat, feed grains, upland cotton, and rice apply to payments in commodities by the CCC under the PIK program?

Answer. Yes. The term "payment" as used in the $50,000 limitation applies generally to land diversion "payments" under the Agricultural Act of 1949, as amended; it makes no distinction between payments in cash or in-kind. The statutory limitation and the authorization for land diversion payments must be read together. Thus, if commodities qualify under the authorization for land diversion "payments," as we believe they do, they are likewise subject to the $50,000 limitation on such "payments."

The Agriculture Department maintains that the limitation does not apply to in-kind payments because "a major focus" prompting its enactment was congressional concern over budgetary impacts—a concern which, in the Department's view, has no relevance to in-kind payments. However, the legislative history clearly, shows that Congress' concern went well beyond budgetary impacts; it evidences a more generalized intent to preclude what were perceived as inordiante and inequitable payments to any single producer. This concern seems just as relevant to in-kind payments. At the very least, the "focus" in the legislative history relied on by the Department is insufficient to justify reading into the limitation a distinction between cash and in-kind payments which is nowhere suggested in the statute itself.

In connection with out conclusion that the payment limitation does apply to payments in commodities under the PIK program, we must point out that the GAO does not have authority to render opinions binding on the CCC, or to take exception to its payments. Rather, CCC has authority under 15 U.S.C. § 714b to determine the character and necessity for its obligations and expenditures and to settle and adjust its accounts. See B–200103, March 5, 1983, B–200645, September 9, 1981. However, GAO under 31 U.S.C. § 9106 does have authority to report to Congress any activity or expenditure by the CCC which we regard as illegal. B–200103, March 5, 1981.

Question 3. Does the prohibition against the CCC reselling any of its stocks of wheat or feed grains at less than 110 percent of the then current price apply to the disposition of those commodities under the PIK program?

Answer. No. Transfer of commodities for PIK payments is not the transfer or property for valuable consideration necessary to constitute a sale.

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